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Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

\_\_\_\_\_  
In the Matter of )  
)  
)

Annual Assessment of the )  
Status of Competition in )  
Markets for the Delivery )  
of Video Programming )  
)  
\_\_\_\_\_ )

CS Docket No. 97-141

**REPLY COMMENTS OF  
ECHOSTAR COMMUNICATIONS CORPORATION**

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August 20, 1997

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## **SUMMARY**

EchoStar Communications Corporation ("EchoStar") hereby submits its reply comments in the above-captioned matter, where the Commission inquires as to the state of competition in the multi-channel video programming distribution ("MVPD") market. The comments filed by several parties, including significant concessions made by the cable interests themselves, demonstrate that the dominance of cable operators has increased and cable rates have uniformly risen since the Commission's 1996 Competition Report. The views expressed by Ameritech New Media, Inc. ("Ameritech") and others confirm EchoStar's position that the frustration of the transaction between EchoStar and The News Corporation Limited ("News Corp."), and the cable interests' pending attempt to engage in a substitute transaction with News Corp. and MCI Telecommunications Corporation ("MCI"), further threatens to exacerbate the market power of entrenched cable television operators.

Should the PRIMESTAR/News Corp./MCI deal be allowed to proceed, it would prevent use of the unique satellite resources controlled by MCI and News Corp. to compete against cable television on a more equal footing. It would also constitute the single most dramatic increase in vertical integration between cable MSOs and programming services. Indeed, the comments submitted in this proceeding raise serious questions about the relationship between the PRIMESTAR/News Corp. DBS transaction and the grant to News Corp. of long-sought-after carriage for certain of its programming on the cable systems of the PRIMESTAR partners.

The comments submitted by the cable interests confirm that:

- all of the major cable MSOs have increased their rates;<sup>1/</sup>
- the number of cable subscribers has also increased;<sup>2/</sup> and
- the cable operators' share of MVPD households is still alarmingly high at 87% -- only an insignificant decline from the 89% share observed by the Commission in its 1996 Competition Report.<sup>3/</sup>

The increasing cable rates nationwide are proof positive that effective competition in the MVPD market is farther away today than it was at the time of the 1996 Report. While they concede that rate hikes have occurred in the last year, the cable interests try to discount them by making a remarkable assertion: even though rates have increased, the quality of the service has increased *more*, proving that cable operators are under competitive pressure.<sup>4/</sup> The Commission should reject the notion that rate increases are consistent with the possibility of diminishing market power. The facts do not allow for such an absurd conclusion.

The financial community has also seen these cable rate increases for what they are -- evidence of less, not more, competition in the MVPD market. Furthermore, as EchoStar has pointed out, the stock prices for EchoStar and cable MSOs illustrate the financial markets' belief that cable competition has decreased by virtue of the recent thwarting of the transaction between EchoStar and News Corp. In a recent interview aired on CNN Moneyline, Mr. Lou Dobbs asked fund manager Mr. Mario Gabelli why he favors cable and media stocks. Mr. Gabelli responded:

Well, I think there's less competition in cable. Murdoch had a DeathStar that had been -- has been grounded. Satellite will still be in competition. The telcos -- telephone companies -- are not

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<sup>1/</sup> Comments of the National Cable Television Association ("NCTA") at 18-21.

<sup>2/</sup> See NCTA Comments at 3, 16.

<sup>3/</sup> See NCTA Comments at 1.

<sup>4/</sup> See NCTA Comments at 3, 17-18.

competing as aggressively, and the other entrants are not there. More importantly, cash flows are improving, their service levels are improving . . . .

CNN Moneyline with Lou Dobbs (July 25, 1997).

The anti-competitive consequences of News Corp.'s shift from joining a DBS provider to the cable MSOs have not gone unnoticed by other commenters. According to Ameritech, "News Corp. apparently has traded in competition to cable for carriage on cable." Ameritech Comments at 37. An example of such a "trade-in" is apparently the recent settlement of News Corp.'s dispute with PRIMESTAR partner Time Warner over Time Warner's refusal to carry Fox News on Time Warner's New York cable systems.<sup>5/</sup> The Commission should investigate carefully the motives of the parties and the effective consideration for that settlement and its relationship with the proposed PRIMESTAR/News Corp./MCI transaction.

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<sup>5/</sup> Communications Daily, July 24, 1997. Time Warner will carry Fox News Channel on its Manhattan cable system as part of a settlement with News Corp. The deal will give 65% of Time Warner systems 24-hour access to Fox News in exchange for time Warner access to News Corp. satellite system. Id.

## **TABLE OF CONTENTS**

	<u>Page</u>
SUMMARY .....	i
I. THE CABLE COMMENTERS CONCEDE THAT CABLE RATES HAVE INCREASED .....	1
II. INVESTORS HAVE TURNED TO CABLE MSO STOCKS BECAUSE THERE IS "LESS COMPETITION IN CABLE" .....	4
III. THE COMMISSION SHOULD EXPLORE THE POSSIBILITY OF COERCION AS A REASON BEHIND THE PRIMESTAR/NEWS CORP. DEAL .....	6
IV. EFFECTIVE TERRESTRIAL COMPETITION TO CABLE TELEVISION HAS YET TO EMERGE .....	7
V. VERTICAL INTEGRATION IS ON THE VERGE OF A DISCONCERTING INCREASE .....	10
CONCLUSION .....	11

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**I. THE CABLE COMMENTERS CONCEDE THAT CABLE RATES  
HAVE INCREASED**

The comments submitted by the cable interests confirm that:

- all of the major cable MSOs have increased their rates;<sup>1/</sup>

<sup>1/</sup> Comments of the National Cable Television Association ("NCTA") at 18 ("The increased costs ... along with inflation and price increases held back from prior years under Commission rules, have put upward pressure on rates."). Id. at 20 ("TCI's recent price increases, for example,

(continued ...)

- the number of cable subscribers has also increased;<sup>2/</sup> and
- the cable operators' share of MVPD households is still alarmingly high at 87% -- only an insignificant decline from the 89% share observed by the Commission in its 1996 Competition Report.<sup>3/</sup>

The increasing cable rates nationwide are proof positive that effective competition in the MVPD market is farther away today than it was at the time of the 1996 Report. While they concede that rate hikes have occurred in the last year, the cable interests try to discount them by making a remarkable assertion: even though rates have increased, the quality of the service has increased *more*, proving that cable operators are under competitive pressure.<sup>4/</sup> The Commission should reject the notion that rate increases are consistent with the possibility of diminishing market power. The facts do not allow for such an absurd conclusion.

The cable interests argue, among other things, that the MVPD market is more competitive because, while cable prices have risen, some cable systems (by no means the majority) have added the Disney channel or the regional sports channel to their expanded basic

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<sup>1/</sup> (... continued)  
were driven primarily by ... ."). Id. ("Time Warner's increases in regulated tier rates over the past year are largely attributable to ... ."). Id. at 20-21 (explaining price increases by MediaOne, Cox and Comcast). See also Comments of US West, Inc. at 19 (average MediaOne increases were 5.7%).

<sup>2/</sup> See NCTA Comments at 3 (arguing that cable companies have gained customers because they have responded effectively to competition). Id. at 16 (in 1996-97, cable subscribership grew by 2.5%).

<sup>3/</sup> See NCTA Comments at 1.

<sup>4/</sup> See NCTA Comments at 18 ("rate increases correlate with more and better cable services."). Id. at 3. Id. at 17 ("while entry and greater competition may lead to lower prices in some markets, entry and greater competition may also lead to higher prices along with higher quality in other markets.").

tier.<sup>5/</sup> They maintain that, for those subscribers who had previously watched these channels, then inclusion in the expanded basic tier could result in overall savings. Of course, all of the other subscribers to the expanded basic tier experience the full burden of these rate increases. While NCTA argues that these subscribers receive "more value" with the expansion of the tier, *id.*, this extra value is essentially forced "down their throat," together with the rate increases. The cable interests do not explain why, instead of increasing rates and including Disney or a regional sports channel in the expanded basic tier, cable systems did not follow any of the following courses of action:

- decrease rates for the basic tier, thus also decreasing the overall rates for that tier plus the extra channel (if they wanted to appeal to all "expanded basic" subscribers); or
- at least hold steady the rates for the basic tier and reduce rates for the premium channel (if they wanted to appeal to subscribers to that channel).

Nor does the NCTA acknowledge that inclusion of an additional channel is, in fact, consistent with the classic behavioral pattern of a regulated monopolist wishing to increase its rates and elude regulatory scrutiny by invoking a cost increase as a justification. For that matter, the cable interests do not show how their rate increases relate to an increase in the cost of the additional channel included in the basic tier. They only argue that the rate increases are *partly* due to programming cost increases.<sup>6/</sup> Nor does the NCTA assert that cable systems have expanded their basic tier everywhere where they have raised rates.

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<sup>5/</sup> See NCTA Comments at 25. Comments of US West, Inc. at 21 ("Although the retail price for the expanded basic tiers had increased slightly with the movement of such channels, the downward migration . . . represents a significant enhancement to the expanded tier.").

<sup>6/</sup> See NCT Comments at 18-21. Comments of US West, Inc. at 19.



In fact, expansion of the basic tier associated with a price increase falls within a widely acknowledged exception to the rule that a monopolist cannot further leverage its market power over one product by requiring buyers of that product to buy another product. Under that exception, the monopolist can leverage its power through tying two products when its market power over the one product is tempered by rate regulation or even heightened regulatory awareness and scrutiny.<sup>7/</sup> Such a monopolist can capture more of the monopoly rent when the tying of two products in a single package helps it evade regulation. Therefore, the phenomenon cited by NCTA as "consistent with a competitive model" is, in fact, consistent with a monopolist's attempt to exercise its market power to a fuller extent.

The Commission should accept nothing short of price competition as an indication of a more competitive market. Indeed, the Commission has made clear that its goal is to promote price competition, as opposed to product differentiation strategies, between cable operators and DBS providers in the MVPD market.<sup>8/</sup>

## **II. INVESTORS HAVE TURNED TO CABLE MSO STOCKS BECAUSE THERE IS "LESS COMPETITION IN CABLE"**

The financial community has also seen these cable rate increases for what they are -- evidence of less, not more, competition in the MVPD market. Furthermore, as EchoStar has pointed out, the stock prices for EchoStar and cable MSOs illustrate the financial markets' belief that cable competition has decreased by virtue of the recent thwarting of the transaction between

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<sup>7/</sup> See Lamoille Valley R.R. v. ICC, 711 F.2d 295, 318 (D.C. Cir. 1983) (discussing the related context of vertical integration) (citing 3 P. Areeda & D. Turner, Antitrust Law, ¶¶ 725b, 726e).

<sup>8/</sup> Revision of Rules and Policies for the Direct Broadcast Satellite Service, 1 C.R. 928, 943, ¶¶ 48-49 (1995).

EchoStar and News Corp. In a recent interview aired on CNN Moneyline, Mr. Lou Dobbs asked fund manager Mr. Mario Gabelli why he favors cable and media stocks. Mr. Gabelli responded:

Well, I think there's less competition in cable. Murdoch had a DeathStar that had been -- has been grounded. Satellite will still be in competition. The telcos -- telephone companies -- are not competing as aggressively, and the other entrants are not there. More importantly, cash flows are improving, their service levels are improving . . . .

CNN Moneyline with Lou Dobbs (July 25, 1997).

As EchoStar pointed out in its comments the increasing dominance of cable operators is also corroborated by the continually improving financial performance of the large MSOs. The "10-Q" statements filed with the Securities and Exchange Commission for the second quarter of 1997, which became available, confirm the trend of sharply improving revenues and cash flow for three of the largest MSOs: TCI, Time Warner and Comcast.

TCI's revenues increased to 1.9 billion in the second quarter of 1997 compared to 1.7 billion for the same period in 1996.<sup>9/</sup> Its operating cash flow (operating before depreciation, amortization, compensation relating to stock appreciation rights and adjustments to compensation relating to stock appreciation rights) rose from 1 billion to 1.5 billion (six month period ending June 30, 1996 and 1997, respectively). Likewise, operating income grew to \$253 million from \$169 million.

Time Warner's revenues from cable system operations (not including revenues from programming) rose from \$230 million (second quarter 1996) to \$250 million (second

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<sup>9/</sup> Form 10-Q filed by Tele-Communications, Inc. (Aug. 13, 1997). The 1997 revenue number does not include net sales from electronic retailing services.

quarter 1997).<sup>10/</sup> It's operating income from cable operations increased to \$35 million from \$20 million.

Comcast Corporation has also experienced significant financial improvement. It reported an increase in its revenues from domestic cable communications from \$520 million in the second quarter of 1996 to \$1 billion in the second quarter of 1997.<sup>11/</sup> Similarly, operating income increased from \$78 million in the second quarter of 1996 to \$170 million for the second quarter of 1997.<sup>12/</sup>

### **III. THE COMMISSION SHOULD EXPLORE THE POSSIBILITY OF COERCION AS A REASON BEHIND THE PRIMESTAR/NEWS CORP. DEAL**

The anti-competitive consequences of News Corp.'s shift from joining a DBS provider to the cable MSOs have not gone unnoticed by other commenters. According to Ameritech:

Most noteworthy from the perspective of competition in the MVPD marketplace is the stark shift in the posture of NewsCorp from a self-proclaimed arch competitor to cable to one of the most powerful cable programmers with enormous leverage over cable operators, especially new entrants. In February 1997, the announcement of the NewsCorp/EchoStar direct broadcast satellite deal promised formidable competition to cable, even while it raised many concerns. Following the collapse of that merger, however, News Corp. apparently has traded in competition to cable for carriage on cable.

Ameritech Comments at 37. *See also* Comments of Bell Atlantic and NYNEX at 5.

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<sup>10/</sup> Form 10-Q filed by Time Warner Inc. (Aug. 8, 1997).

<sup>11/</sup> Form 10-Q filed by Comcast Corporation (Aug. 14, 1997).

<sup>12/</sup> Of the largest MSOs, Cox Communications, Inc. was only one that experienced a decline in its operating income (\$55 million to \$43 million, from second quarter 1996 to 1997, respectively), despite increased revenues of \$401 million from \$357 million. Form 10-Q filed by Cox Communications, Inc. (Aug. 13, 1997).

As evidence of this apparent "trade-in" Ameritech cites to the News Corp./TCI and Cablevision agreement to combine their regional sports channels and other sports assets, creating a virtual nationwide stranglehold over regional sports programming with a total of 22 channels. Another example of such a trade-in is apparently the recent settlement of News Corp.'s dispute with PRIMESTAR partner Time Warner over Time Warner's refusal to carry Fox News on Time Warner's New York cable systems. As the press has recently reported:

Time Warner said Wed. [July 23, 1997] it will carry Fox News Channel on its Manhattan cable system as part of settlement of disputes with News Corp. (NC). Additional terms were confidential, but published reports suggested deal is part of larger pact that will grant 24-hour Fox News access to 65% of TW systems in exchange for TW access to NC satellite system.

Communications Daily (July 24, 1997).

The Commission should investigate carefully the motives of the parties and the effective consideration for that settlement and its relationship with the proposed PRIMESTAR/News Corp./MCI transaction. The Commission should also explore the possibility that News Corp. may have been pressured to turn over its DBS satellites and spectrum resources to PRIMESTAR in exchange for programming carriage on cable.

#### **IV. EFFECTIVE TERRESTRIAL COMPETITION TO CABLE TELEVISION HAS YET TO EMERGE**

The initial comments, as well as subsequent developments, confirm the continued absence of any terrestrial alternatives to cable television, except on a very limited scale. In the words of Mr. Gabelli, the telephone companies "are not competing as aggressively, and the other entrants are not there ... ." CNN Moneyline with Lou Dobbs (July 25, 1997).

Of the "Baby Bells" that submitted comments in the proceeding, US West has elected a strategy of simply acquiring cable systems, *i.e.*, becoming the dominant cable operator in a franchise area as opposed to competing against the cable operator. Through the acquisition of Continental Cablevision's cable systems, US West has become one of the largest MSOs in the country, with more than 4 million subscribers. This strategy makes it highly unlikely that US West will aggressively pursue and expand its earlier Video Dial Tone experiments.

US West asserts that its service to 43,000 homes in Omaha, Nebraska (legacy of its VDT experiment) "competes directly with two other franchised cable operators in its service area . . . ." US West Comments at 7. Nevertheless, US West does not indicate any plans to expand that modest offering and compete against other MSOs. Thus, while the Commission had already observed US West's acquisition of Continental Cablevision, Inc. in the 1996 Competition Report, *see* 1996 Competition Report at ¶ 75, the intervening year has seen the apparent freezing of any previous pro-competitive entry by US West and the crystallization of the company as an MVPD incumbent.

Nor do the other Baby Bells report significant progress in their efforts to enter the MVPD market. Even Ameritech, the most aggressive entrant, reports that it currently offers cable television service to consumers in only 28 communities in the Chicago, Detroit, Cleveland and Columbus areas.<sup>13/</sup> This is a relatively modest increase compared to the 17 operational franchises observed in the 1996 Competition Report.<sup>14/</sup> BellSouth has not yet commenced

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<sup>13/</sup> See Ameritech Comments at 8-9.

<sup>14/</sup> 1996 Competition Report at ¶ 73.

providing wireless cable service in any of the areas mentioned in the 1996 Competition Report.<sup>15/</sup> Furthermore, while Bell South has now obtained 17 cable franchises (compared to 7 at the end of 1996, *see* 1996 Competition Report at ¶ 74 and n. 233), it does not appear to have yet rolled out service beyond the one area in Chamblee and Dekalb County, Georgia already examined in the 1996 Competition Report.<sup>16/</sup> Southern New England Telephone Company ("SNET"), which has not filed comments in this proceeding, has likewise not significantly progressed since receiving a statewide Connecticut franchise in 1996.<sup>17/</sup> SNET has apparently launched service in just one community -- Unionville, Connecticut.<sup>18/</sup>

Generally, what the cable interests cite as steps toward a less cable-dominated market are for the most part minimal steps -- franchises or licenses that have been received, with very few instances of commencement of actual service. *See* Comments of US West, Inc. at 5-9 (mostly citing franchises or licenses held by Ameritech, SNET and BellSouth). The Commission cannot rely on the grant of authorizations as evidence of progress.

Furthermore, recent developments exacerbate the uncertainty over the emergence of robust terrestrial competitors in the MVPD market. The Commission had placed hope on Tele-TV and Americast, the two LEC joint ventures for video programming and packaging, as

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<sup>15/</sup> Compare 1996 Competition Report at ¶ 72 and n. 229 with Comments of BellSouth's Corporation, BellSouth Interactive Media Services, Inc. and BellSouth Wireless Cable, Inc. at 7 (reporting on schedule to launch digital wireless cable service "in New Orleans and Atlanta during the fourth quarter of 1997, in Jacksonville and Orlando during the first half of 1998 and in Miami/Ft. Lauderdale and Louisville during the second half of 1998.") (footnote omitted).

<sup>16/</sup> Compare 1996 Competition Report at ¶ ¶ 213-217 with BellSouth Comments at 7.

<sup>17/</sup> See 1996 Competition Report at ¶ 74.

<sup>18/</sup> US West Comments at 6.

two promising vehicles for introducing cable competition. *See* 1995 Competition Report, 11 FCC Rcd. at 2109 ¶ 100. The 1996 Competition Report had voiced some doubt about the viability of these ventures and had pointed to reports of fundamental change in Tele-TV's plans. Nevertheless, the Commission reported that Tele-TV had begun to offer an analog-to-digital conversion service, and Americast had announced its plan to offer a basic national service. *See* 1996 Competition Report at ¶ 78. As of today, one venture has been abandoned and the other appears moribund. Tele-TV "folded when former partner Pacific Telesis was absorbed into Americast partner SBC Communications." Communications Daily (August 11, 1997) at 11. Americast, for its part, announced in August that it "is shutting programming unit and cutting staff 10% by end of month . . . ." *Id.*

#### **V. VERTICAL INTEGRATION IS ON THE VERGE OF A DISCONCERTING INCREASE**

The NCTA alleges that the cable industry has experienced a "major drop" in vertical integration over the past year.<sup>19/</sup> Unfortunately, the opposite is closer to the truth. In support of its position, the NCTA cites only Viacom's programming services, which lost their cable affiliation after Viacom disposed of its cable systems. The Commission, however, had already taken account of that development in the 1996 Competition Report,<sup>20/</sup> and it cannot be fairly presented as evidence of a subsequent drop in vertical integration. The NCTA does not cite to any other instance of an MSO disposing of programming service interests.

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<sup>19/</sup> See NCTA Comments at 36.

<sup>20/</sup> See Cable Competition Report at ¶ 142 (Viacom "sold its cable systems to TCI, which means that [its] programming services are no longer vertically integrated.").

To the contrary, as Ameritech and others note, the MVPD market may be about to experience perhaps the single greatest increase in vertical integration since its inception. The PRIMESTAR/News Corp. transaction, compounded by other related deals between News Corp. and the cable interests, would create for the first time a cable stranglehold over News Corp.'s programming assets, including valuable sports and movie rights. The attached chart dramatically illustrates the scope of the proposed increase in vertical integration.

### CONCLUSION

Cable operators' increasing market power has allowed them to increase their rates with impunity, even in a regime of rate regulation. Unless the Commission stops the proposed PRIMESTAR/News Corp. transaction, the effort to promote competition in the MVPD market will suffer its worst-ever set-back.

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EchoStar Communications Corporation

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, Sky Soap, Sky Travel, The Computer Channel, Nickelodeon UK, History Channel, Sky Scottish, Granada Sky Broadcasting, Granada Plus, & Motors, Granada TV High Street, Granada Food & Wine, Granada Health & Beauty, Granada Home & Garden, QVC, Fox Kids, Sky Movies, Sky Movies Gold, Sky Sports 2, Sky Sports 3, TNT.

FOX History, FOX Soap, FOX Talk, FOX Travel, FOXTEL Weather, FX, Nickelodeon, red, The Comedy Channel, UK TV, FOX Sports, Sky even Network.

channel, Star Plus, Star Plus Japan, Star Movies, Star Movies Japan, Star Movies SE Asia, ESPN Star Sports, Star TV Hong Kong, Star TV British

## **CERTIFICATE OF SERVICE**

I hereby certify that on this 20th day of August, 1997, I caused copies of the foregoing pleading to be served by hand delivery to the following:

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A handwritten signature in black ink, appearing to read 'P. Michalopoulos', is written over a horizontal line.

Pantelis Michalopoulos